

PARTIAL BIDS

The Problem of Coercion and a Proposal for Reform

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Introduction

In Ontario, Part XX of the *Securities Act* (the "Act" and with corresponding rules and regulations, the "Ontario take-over bid regime") governs take-over bids.¹ The Act defines a take-over bid as an offer to acquire outstanding voting or equity securities of any class of a company that, if acquired, would result in the offeror acquiring an aggregate of 20% or more of the outstanding securities of that class.² Since there is nothing in the Act that requires an offeror to bid for all of the issued and outstanding securities of a target company, an offeror may bid for some of the outstanding securities of that company,

¹ For provinces outside of Ontario, Multilateral Instrument 62-104 – *Take-Over Bids and Issuer Bids* ("MI 62-104"), applies. The proposals set out in this article in respect of the Ontario take-over bid regime are also applicable to MI 62-104.

² *Securities Act*, R.S.O. 1990, c. S.5, s. 89(1):

"take-over bid" means an offer to acquire outstanding voting securities or equity securities of a class made to one or more persons or companies, any of whom is in Ontario or whose last address as shown on the books of the offeree issuer is in Ontario, where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20 per cent or more of the outstanding securities of that class of securities at the date of the offer to acquire but does not include an offer to acquire if the offer to acquire is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders.

allowing the offeror to acquire *de facto* control without acquiring the entire company. This is known as a partial bid. There are currently no rules in the Ontario take-over bid regime specific to partial bids. If a partial bid is made for 20% or more of the outstanding securities of a class of the target company, the bid must comply with the Ontario take-over bid regime.

The role of partial bids in capital markets has been the subject of much debate. Those who view partial bids as beneficial see them as consistent with the Ontario take-over bid regime's intended objectives of, among other things, exacting discipline on corporate management and reallocating resources to their best uses.³ Opponents of partial bids describe them as inevitably and inherently coercive. Under the current Ontario take-over bid regime, when an offeror makes a partial bid for shares in a company, the target company's shareholders are required to decide whether to tender their shares to the offer. In the event that shareholders view the bid as inadequate or otherwise unfavourable, they may respond to the bid in one of two ways: (i) refrain from tendering their shares in order to attempt to maintain the status quo; or (ii) tender their shares in order to avoid remaining shareholders in a company that they believe may be less valuable and less liquid post-bid. The latter response is referred to as the problem of coercion. Critics of partial bids suggest that, when faced with a Hobson's choice of tendering shares to a possibly inadequate partial bid or being left holding a minority position in a less liquid company, shareholders may feel coerced to tender their shares.

It is in this context that this article attempts to shift this debate by arguing that partial bids, if regulated differently, may be viewed more broadly as a positive component of the Ontario take-over bid regime. To address the critics of partial bids and to mitigate the problems of coercion they associate with partial bids, this article proposes a new regulatory scheme for hostile bids that would result in the offeror holding an aggregate of 30% or more of the outstanding voting or equity securities of the target company. The new scheme would separate each

³ Ian Ramsay, "Balancing Law and Economics: the Case of Partial Take-overs" (1992) *J. Bus. L.* 369 at 369; National Policy, OSC NP 62-202, (August 4, 1997), s. 1.1(1).

shareholder's decision of whether to tender to the bid and that shareholder's decision to either support or reject the overall bid. First, shareholders would decide whether to tender their shares. Second, shareholders would complete a "bid ballot," an approval document mailed to them with the bid materials, to either approve or reject the bid. This process would mitigate perceived problems of coercion and help to remedy inefficient outcomes that may result under the current regime. Consequently, partial bids may become a more effective tool to facilitate changes of control in corporate entities.

The Current Regime

Under the current Ontario take-over bid regime, an offeror must make an offer to acquire a portion of the outstanding shares of the target company by way of a take-over bid circular, which sets out the terms of the offer and other relevant information about the offeror. The take-over bid circular is mailed to all shareholders of the target.⁴ The directors of the target company are then required to respond to the bid by preparing and sending a directors' circular to all shareholders within 15 days of the date of the bid.⁵ The offer must remain open to the target company's shareholders for at least 35 days from the date of the bid.⁶ Once all of the terms and conditions of the bid have been met or waived, the offeror is obligated, within 10 days after the expiry of the bid, to take up and pay for the deposited shares.⁷ In the event that more than the number of shares offered to be purchased are tendered, the offeror must take up and pay for the shares on a *pro rata* basis.^{8/9}

Understanding the Shareholder's Dilemma Under the Current Regime – Partial Bids and the Coercion Problem

Assume that a target company's shares are trading at \$10 per share. The offeror makes a

⁴ Supra note 2 at ss. 94.1(b) and 94. The offeror has an obligation to extend the offer to all holders of the class of securities subject to the bid.

⁵ Ibid. at s. 95(1).

⁶ Ibid. at s. 98(1).

⁷ Ibid. at s. 98.3(1).

⁸ Ibid. at s. 97.2(1).

⁹ A discussion of shareholder rights plans and their impact on the process of partial bids in the context of the current and proposed regimes is beyond the scope of this article.

partial bid for 50% of the outstanding shares of the target at \$13 per share. The target company's shareholders view this as an unfavourable bid, as they believe that the post-bid price of the shares will decline to \$5. In this scenario, it would be logical for shareholders to reject the bid and maintain the status quo as it is preferable to hold shares in the target company at \$10 per share rather than sell half of those shares at \$13 per share and hold the remainder at \$5 per share.

However, since the individual shareholder has no way of knowing whether the other shareholders are prepared to reject the bid, any individual shareholder whose holdings are too small to influence the outcome of the bid will accept the bid in order to maximize individual gain rather than reject the bid on its merits. If the shareholder believes that the majority of the target company's shareholders will tender to the bid, it makes sense for the shareholder to mitigate losses and realize \$13 per share rather than hold a minority interest in a post-bid company that may be worth only \$5 per share. On the other hand, if the shareholder believes that the majority of the target company's shareholders will not tender their shares and will reject the bid, the shareholder will still tender in order to realize the premium being offered. Regardless of whether the individual shareholder believes that the majority will approve or reject the bid, the shareholder will have an incentive to tender its shares. Since all shareholders will have the same incentive, each shareholder will tender and suffer a loss of \$1 per share in the transaction. Instead of having a share worth \$10 had they rejected the bid, shareholders will receive \$13 per share for half of their shares and \$5 per share for the other half such that the value of each of their shares would on average be \$9.¹⁰ In an effort to secure their individual gain, shareholders will tender to the bid even though the overall outcome is ultimately wealth-decreasing to shareholders.

In summary, this hypothetical fact pattern illustrates the "coercion problem" said to arise from partial bids – when shareholders believe that the post-bid value of their shares will decrease, they will tender, even though it is

¹⁰ Sharon Hannes and Omri Yadlin, "The SEC Regulation of Take-overs: Some Doubts from a Game Theory Perspective and a Proposal for Reform" (2008) 25 *Yale J. on Reg.* 35 at 44.

contrary to their overall long-term best interest. This outcome is the focus of the arguments made by critics of partial bids.

The Proposed Regime for Partial Bids

The proposed regime for partial bids in Ontario would include an additional step not currently featured in the existing Ontario take-over bid regime.¹¹ Instead of only tendering their shares, shareholders would also be asked to complete a "bid ballot" mailed to them with the offeror's take-over bid circular. The bid ballot would give the target company's shareholders (other than the offeror and its joint actors) the option to either accept or reject the

bid, based on its merits. The decision to approve or reject the bid would be independent of the shareholders' decision to tender. If all the bid conditions were satisfied and a majority of all shareholders who submitted a bid ballot were to accept the bid, the bid would be consummated. If, however, all the bid conditions were satisfied but a majority of shareholders who submitted a bid ballot were to reject the bid, the bid would fail. In other words, the shareholders' tendering decision alone would no longer be determinative of the success or failure of the take-over bid.

The following chart compares the current and proposed regimes and highlights the proposed changes to the current regime:

¹¹ The proposals contemplated in this article could also be incorporated into MI 62-104, supra note 1.

Day	Current Regime	Proposed Regime
Day 1	Take-over bid circular mailed to all shareholders.	Take-over bid circular and, when the bid, if successful, would result in the offeror holding in aggregate 30% or more of the target company, an accompanying bid ballot is mailed to shareholders.
Up to day 15	Directors' circular mailed to all shareholders.	Directors' circular mailed to all shareholders.
Up to day 35	Offer to tender open to all shareholders.	Offer to tender open to all shareholders. Shareholders (other than the offeror and its joint actors) return bid ballot indicating approval or rejection of the offer.
Day 35	Offer expires. If all bid conditions are satisfied, press release issued and offeror commences take up and payment of shares.	Offer expires. Bid ballots are tallied. If all bid conditions are satisfied and a majority of all shareholders who returned a bid ballot approved the bid, press release issued and offeror commences take up and payment of shares.

By separating the target company's shareholders' tendering decision from the decision

to approve or reject the bid, those instances in which shareholders tender, for strategic

reasons, to an unfavourable bid may no longer result in a successful take-over, addressing the problem of coercion.

Under the proposed regime, if a majority of the target company's shareholders believe the bid is unfavourable, and that the post-bid price of their shares will decrease, the following two scenarios are possible: (i) shareholders may refrain from tendering to the bid, motivated in the face of a disadvantageous bid to maintain the status quo and reject the bid on the bid ballot; or (ii) shareholders may tender to the bid, motivated by self-interest not to become a minority shareholder in the post-bid company if the bid is accepted but also reject the bid on the bid ballot. In both scenarios, an unfavourable bid would fail. Shareholders would be shielded from the perceived "coercion problem."

Understanding the Proposal in the Context of Other Regulatory Frameworks

The experience in the United Kingdom and New Zealand, two jurisdictions whose experience is instructive for the proposed regime for partial bids in Ontario, demonstrate how similar regulatory frameworks for partial bids have been adopted and implemented.¹²

The United Kingdom

The City Code on Takeovers and Mergers (the "City Code") is the regulatory framework governing tender offers in the United Kingdom. It sets out the general principles and rules that govern tender offers, including partial offers. The City Code is issued and administered by the Takeover Panel, a supervisory authority designated to carry out regulatory functions, which has the authority to oversee tender offers.¹³

In the United Kingdom, tender offers are initiated when an offeror makes an announcement of its firm intention to bid for the target

company. An offering document soon follows, outlining the particulars of the offer.¹⁴ The target company's board has 14 days from the posting of the offer document to respond to the offer by way of a board circular.¹⁵ The offer must remain open for at least 21 days from the date it is posted and must be made to all shareholders.¹⁶ Unlike the Ontario take-over bid regime, the City Code specifically outlines rules governing partial offers. In particular, the City Code requires prior consent of the Takeover Panel for any partial offer.¹⁷ Consent is normally granted if a partial offer does not result in the offeror acquiring more than 30% of the voting rights of the target company. However, consent will likely not be given if the partial bid is for more than 30% of the voting rights of the target company and the offeror has acquired shares of the target during the 12 months preceding the application for consent or at any time after the offer was reasonably in contemplation. The Takeover Panel will often withhold consent in this circumstance in order to ensure that the target company's shareholders are treated equally. Withholding consent helps to avoid a situation in which some shareholders are able to sell their shares prior to the formal offer, while the remainder may have the opportunity to sell a lesser amount of their shares only in the partial offer.

In situations where the offeror bids for 30% or more of the target company's outstanding voting shares, in order to get the Takeover Panel's approval, the offer must be conditional on obtaining the specified number of shares and on approval of the offer by a majority of shareholders who are independent of the offeror. Shareholders approve or reject the bid by marking a check box on a bid ballot or form of acceptance.

New Zealand

Take-over bids in New Zealand are governed by the Takeovers Code, which came into effect in 2000. The Takeovers Code is enforced by the Takeovers Panel, a body

¹² In the United States, the regulatory regime applied to partial bids is substantially similar to the current Ontario take-over bid regime; in the context of this proposal, there is nothing to draw from the U.S. experience.

¹³ The Takeover Panel's supervisory authority in relation to take-over bids has been designated under the EC Directive on Takeover Bids (2004/25/EC). Its statutory functions are set out in and under Chapter 1 of Part 28 of the *Companies Act, 2006*.

¹⁴ The Panel on Takeovers and Mergers, *The Takeovers Code* (London, United Kingdom) at rule 2.5, online: The Takeover Panel <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf>.

¹⁵ *Ibid.* at rule 25.1 and 30.2.

¹⁶ *Ibid.* at rule 31.1.

¹⁷ *Ibid.* at rule 36.1.

established by the *Takeovers Act of 1993*. The Takeovers Code permits partial bids, provided the offer is extended to all shareholders of the target company. The Takeovers Code divides partial bids into two categories: (i) partial bids that, when taken together with the securities already held by the offeror, account for more than 50% of the voting rights of the target; and (ii) those that do not account for more than 50% of the voting rights of the target company. When a partial bid falls into the second category, the offeror must comply with a shareholder approval process. Specifically, the offer must be accompanied by an approval document (similar to the proposed bid ballot), which allows the target company's shareholders to either approve or reject the offer. The approval process requires a majority of the voting shareholders, excluding the offeror and its associates, to approve the offer.¹⁸

Comparative Analysis

The proposal for reform of the current Ontario take-over bid regime that is outlined in this article draws from, and is informed by, both the New Zealand Takeovers Code and the United Kingdom City Code in their regulation of partial bids.

Under both the New Zealand Takeovers Code and the proposed regime for Ontario, the success of a partial bid depends not only on the number of shares tendered to the offer, but also on the approval of the bid by the target company's shareholders. In New Zealand, such approval is given by way of an approval document. In Ontario, the bid would be approved or rejected by way of bid ballot. While very similar in this respect, the proposed regime for Ontario differs from the New Zealand Takeovers Code in that the Takeovers Code requires shareholders to approve an offer only if it is for 50% or less of the outstanding voting securities of the target company. Under the regime proposed for Ontario, shareholders would be asked to approve any bid that could result in the offeror holding in the aggregate 30% or more of the voting rights of the target company. The proposed regime would apply

not only when an offeror intends to acquire enough shares to enable the offeror to control the direction of a target company without acquiring a majority stake – *de facto* control – but also when the offeror intends to acquire a majority stake in the target company.

In this way, the proposed regime mirrors the United Kingdom City Code, which requires shareholder approval for any bid that could result in the offeror holding in the aggregate 30% or more of the voting rights of the target company. However, unlike the City Code, the proposed regime would not require that prior regulatory consent be obtained in order for a partial bid to proceed and would, in an effort to respect the importance of shareholder choice in the take-over bid regime, preserve the right of shareholders to decide for themselves the acceptability of a partial bid.

The regulatory regimes in both New Zealand and the United Kingdom, although different in certain ways from the proposed regime for Ontario, demonstrate that a proposal that asks shareholders to approve or reject a partial bid is feasible. An approval mechanism that makes the success of a partial bid contingent not only on the number of shares tendered, but also on the decision of shareholders as to the merits of that bid, offers greater protection to shareholders than the current Ontario take-over bid regime.

Conclusion

The proposed regime for partial bids in Ontario includes an approval mechanism, which would promote the rejection of unfavourable bids while permitting the approval of advantageous ones. The addition of an approval mechanism to the current regulatory regime would aim to correct some of the results that critics of partial bids associate with the problem of coercion. By making the success of a partial bid conditional on meeting the offeror's conditions as to tender and on the approval of a majority of all shareholders who submit a bid ballot, unfavourable bids would be less likely to succeed. In this way, the take-over bid regime in Ontario would be strengthened by establishing a framework that acknowledges the benefits of partial bids while mitigating some of their more potentially coercive elements.

¹⁸ Takeovers Panel, *Takeovers Code* (New Zealand) at rules 9-10, online: Takeovers Code Approval Order 2000, http://www.legislation.govt.nz/regulation/public/2000/0210/latest/DLM10101.html?search=ts_all%40act%40bill%40regulation_Takeovers+Code+Approval+Order_resel&p=1.